**SRI-HARTAMAS DEVELOPMENT SDN. BHD.**

**v.**

**MBf FINANCE BHD.**

HIGH COURT MALAYA, KUALA LUMPUR
SITI NORMA YAAKOB J
[ORIGINATING SUMMONS NO. D2-24-198-89]
30 AUGUST 1989

***COMPANY LAW:*** *Restraining order - Application by unsecured creditor to set aside order - Protection of interest of unsecured creditors - Requirements of s. 176(1) Companies Act - Two steps - Procedural and supervisory - Whether composite scheme of arrangement viable - Practical implications of scheme - Whether Court can inquire - Section 176(4) Companies Act - Creditors meeting - Voting - Subsequent sanction by the Court.*

On 6 July 1989 the applicant obtained a restraining order, *ex-parte*, to convene separate meetings of classes of its creditors for the purpose of considering and approving at a composite scheme of arrangement and which would further restrain all creditors, their servants or agents from proceeding against the applicant.

The respondent, an unsecured creditor, now applies to have the *ex-parte* order set aside.

**Held:**

**[1]** There was no *bona fide* attempt to conciliate the relations between the applicant and respondent for the common benefit of the other creditors to whom the scheme is also intended to be addressed.

**[2]** The respondent is entitled to raise objections to the scheme at the summary stage.

**[3]** The applicant, at the summary stage need only establish that the Court has the necessary jurisdiction to entertain such an application, and not having ascertained this, the Court must then decide whether the scheme is cast in terms, such that, it achieves the 3/4 majority of all the creditors attending and voting at the creditors meeting under s. 176(3).

**[4]** Despite the objection of a creditor, the majority of creditors may vote for the scheme and the Court would be most reluctant, at the subsequent application for sanction, to hold the scheme as unreasonable.

**[5]** The Court should only overrule the decision of the majority if there had been some material oversight or miscarriage on their part.

**[6]** In the present circumstances, it is not right to shut out the respondent from expressing its misgivings to the scheme that is now under review. The Court must be vigilant, at the summary stage, to ensure that all requirements of s. 176(1) of the Companies Act are met.

*[Application allowed with costs.]*

**Cases referred to:**

*K. Rees Emporium Ltd. [1969] VR 981*
*Re Glendale Land Development Ltd. [1982] 1 ACLC 562*
*Re Price Mitchell Pte Ltd. [1984] 2 ACLC 524*
*Re Buka Minerals NL [1984] 2 ACLC 524*
*Re Sunshine Securities (Pte) Ltd. [1978] 1 MLJ 57*

*Malayan Plant (Pte) Ltd. v. Moscow Norodny Bank Ltd. [1980] 2 MLJ 53*
*Re Hong Huat Realty (M) Sdn. Bhd. [1987] 2 MLJ 502*
*Re Buildmat (Australia) Ltd. [1983] 1 ACLC 919*
*Re NFU Development Trust Ltd. [1973] 1 All ER 135*
*Re GAE Pte Ltd. [1962] VR 252*
*Re English, Scottish and Australian Chartered Bank [1893] 3 Chz 385*

**Legislation referred to:**
Companies Act 1961 [Aust], s. 181
Companies Act 1965, ss. 176, (1), (3), (4), (10)
Companies Code (NSW) [AUST], ss. 315(1), (4)

*For the respondent/applicant - Loh Siew Cheang (Nik Aliena Salwanee with him); M/s. Cheang & Ariff*
*For the applicant/respondent - Dato' Wong Soon Foh (Chong Wei Lung with him); M/s. Chooi & Co.*

**JUDGMENT**

**Siti Norma Yaakob J:**

On 6 July 1989, the applicant obtained an order, *ex-parte*, to convene separate meetings of 3 classes of its creditors for the purpose of considering and approving a composite scheme of arrangement, (the scheme), pursuant to s. 176(1) of the Companies Act 1965, (the Act). The order also specifies the date, place and times of the meetings, directions as to the convening of such meetings and restrains all the applicant's creditors, their servants, or agents from proceeding against the applicant under s. 176(10) of the Act, except by leave of the Court.

The respondent, an unsecured creditor, who has been affected by the restraining order and who has been added a party to these proceedings, now applies to have the *ex-parte* order set aside on the grounds that the Court had no jurisdiction to make such an order in the first place or alternatively if the Court had the jurisdiction, the order ought not to have been made as the scheme provides no safeguards to protect the interests of the unsecured creditors.

Section 176 of the Act deals specifically with the power to compromise with creditors and members of a company and for the purpose of this judgment, 2 subsections are relevant. Subsection (1) provides that:

> where a compromise or arrangement is proposed between a company and its creditors or any class of them ... the Court may on the application in a summary way of the company ... order a meeting of the creditors or a class of creditors ... to be summoned in such manner as the Court directs.

In subsection (3) it is provided that:

> if a majority in number representing three-fourths in value of the creditors or class of creditors ... present and voting agrees to any compromise or arrangement, the compromise or arrangement shall, if approved by order of Court, be binding on all the creditors or class of creditors ...

In *K. Rees Emporium Ltd*. [1969] VR 981, the Supreme Court of Victoria, Australia, when dealing with the same provisions similar to our s. 176(1) appearing as s. 181(1) of the Australia Companies Act 1961, held that the statutory provisions really "require two steps, the first being essentially procedural in nature and the second essentially supervisory ... Generally the application is *ex-parte* and it is assumed that the application is a *bona fide* one". It was based on that procedural and supervisory jurisdiction that the *ex-parte* order was made on 6 July 1989.

Since that order is now being questioned by the respondent giving competing views as to whether the scheme is solely arrived at meeting the interests of the applicant and not of the different classes of creditors, the Court must now give a critical eye as to whether the scheme is a viable one so as to conciliate the relations between the applicant and its 3 classes of creditors for the common benefit of the same classes of creditors to whom the scheme is intended to be addressed. In *re Glendale Land Development Ltd. (No. 2),* [1982] 1 ACLC 562, that same issue has been rephrased by the Supreme Court of New South Wales in the following manner:

> The Court will not ordinarily order meetings under s. 315(1) of the Companies Code (New South Wales) (which is in *pari materia* with our s. 176(1)) unless the proposed compromise or arrangement is of such a nature and cast in such terms that if it achieves the necessary statutory majority (which is our equivalent s. 176(3)), the Court would be likely to approve it on the hearing of an unopposed application under s. 315(4), (which is also in *pari materia* with our s. 176(4)).

Dato' Wong Soon Foh, Counsel for the applicant has submitted that since the Court is ill-equipped to examine the practical implications of the scheme, it should allow the meetings to be convened so that the respondent representing one class of creditors can question the scheme in the same manner that it is now doing before the Court so long as the scheme on the face of it is *bona fide* and that it does not offend any principles of law like public policy and commercial morality.

I accept the fact that this Court is not equipped to inquire into the practical implications of the scheme but nevertheless by virtue of s. 176(4) of the Act, that gives me the discretion not only to order a creditor's meeting under subsection (1) but also to refuse to make an order for such a meeting, I consider that I can evaluate and consider whether the scheme is reasonable and fair so as to benefit all 3 classes of creditors based on the information disclosed by the applicant as to the framework of the scheme itself. For that purpose I shall now consider the significant features of the scheme and their legal aspects and to determine whether they offend any principles of law that negative the exercise of my discretion to order the creditors' meetings in the first place.

The applicant was incorporated on 23 October 1976 and from its very name, it deals in the investment of real property. Out of its authorised share capital of RM50 million, which is divided into 50 million shares of RM1 each, 38.4 million have been issued and credited as fully paid up.

However, due to the drop in the demand for residential and commercial buildings, the applicant is now heavily indebted. One of its projects called City Homes is a total failure but it had already collected well over RM2 million from its purchasers but is not able to make delivery of the apartments sold to them. Besides these City Homes purchasers, the other classes of creditors are the secured creditors to whom the applicant owes well over RM100 million and the unsecured creditors for sums totalling in excess of RM157 million as at 5 May 1989.

The respondent is one of such unsecured creditors to whom a sum of over RM5 million is due and owing pursuant to a final judgment obtained by the respondent against the applicant in Civil Suit 23-2067-87. A creditor's petition has already been presented by the respondent but this has now been restrained by the *ex-parte* order which incidentally was obtained a day before the creditor's petition was to be heard on 7 July 1989.

Despite its apparent insolvency, the applicant is still anxious to develop the only remaining assets it holds, that is lands situated in the city centre, which have already been sub-divided into building lots and what remains to be done is the construction of individual housing and commercial units for sale so as to obtain the best potential value of the land and from such proceeds which the applicant estimates at RM1 billion, it is more than sufficient to settle its outstanding debts after deducting all necessary expenses and cost of the development.

To assist the applicant in the construction of residential and commercial units, it will enter into a joint venture agreement with a Hong Kong based company called First Pacific Land Ltd. who shall develop the lands and together with another London based company called Bovis International Ltd., who shall act as the construction manager, shall use their best endeavours within 90 days of the signing of the joint venture agreement, to obtain credit facilities in the region of RM40 million, RM20 million of which would be utilised to pay off the applicant's tax liabilities, quit rent, assessments and other outgoings, with the remaining RM20 million being utilised as working capital for the project.

To ensure that the sale proceeds from the project are utilised for the purposes of meeting the development costs and repayment of the applicant's debts, First Pacific shall open 2 escrow accounts, A & B, which operate as trust accounts to be managed by two accountants. Escrow account A shall be funded by the working capital of RM20 million plus another 60% of all sale proceeds. It is from this account that all development costs and outgoing shall be met. Escrow account B however will be funded by the remaining 40% of the sale proceeds and such fund shall be utilised solely for the benefit of the applicant's creditors.

First Pacific shall have complete control of the project and for this purpose, the applicant shall grant a power of attorney to First Pacific and that the contract to carry out the project if awarded to First Pacific will be executed through its local subsidiary, yet to be incorporated.

There is also specified in the scheme the formation of a working committee to be comprised of 5 members, one representing the applicant, two representing First Pacific, another representing the financiers of the RM40 million credit facilities and the secured creditors jointly with the remaining member representing the unsecured creditors. It is not too clear what specific functions this working committee shall perform other than to receive progress reports of the project from First Pacific.

Under the scheme, all the secured creditors will be paid in full over a period of 10 years with some adjustments of the interests but with the secured creditors retaining their securities. The unsecured creditors will also be paid in full, after waiver of accrued interest, over a period of 10 years, but with a payment of interest at an agreed rate on the principal sums at the end of the 10 year period if surplus funds are available. As for the City Home purchasers, they may opt to either continue with their respective purchases of apartments or accept payments of agreed liquidated damages on the same basis as the unsecured creditors.

The first objection taken against scheme is that there are no provisions entitling a creditor to enforce the obligations of the parties who are to implement the scheme. Apart from the applicant, who, after the execution of the joint venture agreement, will have no more say in the implementation of the scheme, there are 4 other parties on whose active participation depends the success or otherwise of the scheme. They are (1) First Pacific and its wholly owned subsidiary in Malaysia who are the developers, (2) Bovis, the construction manager, (3) the financiers who are to provide the RM40 million credit facilities and (4) the working

committee. It is the respondent's contention that should any of these 4 parties default in their respective obligations, there is no way by which a creditor can legally proceed against them to have the scheme implemented. It is also the respondent's contention that an undertaking to be given by First Pacific is not good enough and that it goes outside the ambit of s. 176(1).

In *re Price Mitchell Pte Ltd*. [1984] 2 ACLC 524, the propriety of 3 clauses of a proposed scheme were reviewed by the Supreme Court of New South Wales and in refusing to order a creditor's meeting, the Court laid down the following guiding principles to be adopted when exercising the jurisdiction in relation to a scheme.

> The Court is entitled to take into account questions of public policy and commercial morality and the Court is also bound to regard the interest of creditors. For the purpose of protecting the interests of creditors, the Court will ordinarily seek to ensure (1) the terms of the scheme will be enforceable by any creditor who is bound by it against those who implement it or provide the benefits contemplated under it and (2) that the scheme does not, without sufficient reason, include provisions which may create inroads upon, or modify the benefits which a creditor bound by it might legitimately expect to obtain under it.

Unlike *re Price Mitchell*, where the objectionable provisions are expressed negatively in that firstly they exempted the scheme manager who was to administer the scheme fund, from his ordinary civil liability in respect of his activities as a special manager and secondly changed the order of priority for payment to creditors in the event of a winding up of the company which also contravened a statutory provision, the protection that the respondent seeks is not expressed in the scheme itself and that protection involves the presence of provisions in the scheme to enable the respondent to enforce the obligations of any of the four parties who are to implement the scheme. I consider that the respondent's fear is understandable as the scheme is proposed solely for the benefit of creditors like the respondent and for that matter, an undertaking by the First Pacific is inadequate as such an undertaking can only be enforced by the applicant and not by the creditors. Thus should there be any default on the part of either the developer or the construction manager in making payment of moneys due to the respondent from Escrow account B, there is nothing the respondent can do to enforce either of them to make payment.

That same issue was also decided in *re Buka Minerals NL* [1984] 2 ACLC 524 where the scheme sought to be proposed involved the members of 3 companies which I conveniently refer to as Triako, Buka and Elf Triako. All 3 companies are subsidiaries of a fourth company called Elf Aquantaine, who owns all the shares in Elf Triako and 61.6% of the shares in Triako. Triako in turn owns 54.04% of the shares in Buka. The proposal involved the transfer of all the assets and liabilities of Triako and Buka to Elf Triako, that the existing shares in Triako and Buka (except those held by Elf Triako) be cancelled and that in lieu thereof, the existing shareholders of Triako and Buka receive shares in Elf Triako to be alloted according to a formula designed to preserve their proportionate values. The Supreme Court of New South Wales held that what appeared to be missing under the terms of the respective schemes was some means by which a shareholder in Triako or Buka could legally enforce against Elf Triako, the entitlement he was expressed to have under the schemes, once the proposal became effective. For this very reason, the Court was not prepared to make orders under s. 315(1) of the Companies (New South Wales) Code (which is in *pari materia* with our s. 176(1)), unless the parties were prepared to make provisions in the schemes that have the effect of making the cancellation of the shares in Triako and Buka and the transfer to Elf Triako of the assets of the two companies, subject to a condition precedent that the allotment of shares in Elf Triako actually take place.

The effect of this case is clear in that a Court will be most reluctant to exercise its discretion to make an order under s. 176(1) unless the interest of the creditors, the beneficiaries under the proposed arrangement are safeguarded.

The other objection raised is that the applicant is hopelessly insolvent and that it is against public policy to sanction any scheme that it proposes to undertake. The test of the insolvency of any company must be viewed in the commercial sense, that is, its inability to meet current demands irrespective of whether the company is possessed of assets, which if realised, would enable it to discharge its liability in full. See the cases of *re Sunshine Securities (Pte.) Ltd*. [1978], 1 MLJ 57, *Malayan Plant (Pte) Ltd. v. Moscow Norodny Bank Ltd*. [1980] 2 MLJ 53 and *re Hong Huat Realty (M) Sdn. Bhd*. [1987] 2 MLJ 502.

I have already detained the extent of the applicant's liabilities and the fact that it owns lands, the potential value of which need to be tapped by developing them into a housing and commercial estate does not make the applicant any less insolvent. It was in circumstances somewhat similar in the case of *re Buildmat (Australia) Ltd*. [1983] 1 ACLC 919, that the Supreme Court of New South Wales had to consider whether to order a creditors' meeting to approve a proposal to be undertaken by a company that was hopelessly insolvent. In refusing to make the order, the Court held that it is against public policy to approve any scheme to be undertaken by an insolvent company as to order otherwise would amount to the Court "condoning or encouraging persons in our commercial community to carry on business activities in a company which was handicapped by a heavy burden of indebtedness and thereby unable to pay debts in full at any given time". The Court also held that in exercising its discretion, the Court is not only concerned with the interests of the creditors themselves but also with its duty to uphold the commercial morality of the country. Under such circumstances, even if the creditors were to approve the scheme, the Court would not do so. In this respect, the applicant's contention that regardless of its insolvency, an opportunity be given for it to present the scheme to the creditors so that they can object to it, if they wish to, cannot carry any weight as the demands of public policy far outweigh any plea of an opportunity to be heard on the scheme before the creditors.

The respondent also questions the scheme as being neither a compromise nor an arrangement as it is expected to waive all carried interest over a period of 10 years on the judgment it had obtained against the applicant and that an unquantified rate of interest to be agreed will only continue to be paid on the principal sum due at the end of the 10 year period, if surplus funds are available. The word "compromise" and "arrangement" have been defined in the case of *re NFU Development Trust Ltd*. [1973] 1 All ER 135 in the following manner.

> "Compromise" implies some element of accommodation on each side. It is not apt to describe it as total surrender. A claimant who abandons his claim is not compromising it. Similarly the word "arrangement" implies some element of give and take. Confiscation is not an arrangement. A member whose rights are expropriated without any compensating advantage has also been held by the same case as "not having his rights rearranged in any legitimate sense of that expression".

In this case, in consideration of the applicant setting the judgment debt in full, the respondent shall waive all accrued interest and to me the element of accommodating each other is present as on one hand the applicant is prepared to settle the judgment in full, whilst on the other, the respondent is also prepared to waive all accrued interest. As such the respondent's contention that the waiver of accrued interest is a form of confiscation cannot be right as in any form of compromise or arrangement the respondent cannot hope to benefit fully from the judgment debt. The waiver of accrued interest may well be confiscation if the

consideration of repayment does not form part and parcel of the arrangement. It matters not that such an arrangement may not well be to the respondent's full benefit but this is immaterial as to the determination of whether there is a compromise or arrangement in the first place.

Lastly I come to the applicant's contention that under the circumstances of this case, it is premature for the respondent to voice its objections at this stage of the proceedings as firstly all the applicant needs to establish is "a scheme, the general principles of which have been defined and matters must be at a stage where the Court would be justified in ordering a meeting of creditors". See the case of *re GAE Pty Ltd.,* [1962] VR 252. Secondly the respondent has two other forum where it can voice the same objections i.e., to attend the unsecured creditors' meeting, protest it objections and vote against the proposal. If it is outvoted by the other unsecured creditors, it is still at liberty to raise the same objections when the applicant applies to Court under s. 176(4) to sanction the scheme.

To answer the first of the applicant's submission, I have already singled out that the respondent's interests have not been securely safeguarded in that there is no provision in the scheme entitling the respondent to enforce the terms of the scheme against those who are to implement them. In addition it is not disputed that being hopelessly insolvent, it is against public policy to oppose a scheme to be undertaken by an insolvent company even though the creditors may come to approve the scheme if it is presented to them. In this case, if the scheme is implemented, the applicant will be left to carry on business but with liabilities well in excess of RM299 million with no realizable assets whatsoever as the lands would naturally be charged to the financiers to secure the RM40 million credit facilities.

These two matters alone justify my holding that there is no *bona fide* attempt to conciliate the relations between the applicant and respondent for the common benefit of the other creditors to whom the scheme is also intended to be addressed.

As for the applicant's second submission that it is premature to raise any objections to the scheme at this stage of the proceedings, I consider that by virtue of the discretion given to me under s. 176(4), to either order or refuse a creditor's meeting objections can and may be made at the summary stage. That being so, I see nothing objectionable to the respondent raising objections to the scheme at the summary stage rather than allow matters to proceed. Moreover different consideration apply at every stage of the proceedings. At the summary stage when the creditors' meetings are applied for the applicant need only establish that the Court has the necessary jurisdiction to entertain such an application and having so ascertained, the Court must then decide whether the scheme is cast in terms such that it achieves the 3/4 majority of all the creditors attending and voting at the creditors' meetings under s. 176(3) and the Court will be likely to approve it at the subsequent unopposed application for its sanction.

However, at the creditors' meetings, despite the respondent's objections, it may be outvoted by the majority of the other creditors and once the scheme is before the Court again for its approval and sanction, the Court is most reluctant to hold a scheme as being unreasonable as it is greatly influenced by the size of the majority vote and it has been held in the case of *Re English, Scottish and Australian Chartered Bank* [1893] 3 Ch 385, that the Court should only overrule the decision of the majority if there has been some material oversight or miscarriage on their part. Thus the applicant is left with little or no effective recourse once the order under s. 176(1) is made. It is at the summary stage if the proceedings that the Court must be vigilant to ensure that all the requirements of s. 176(1) are met and for this very reason, I consider that it is not right and proper to shut out the respondent from

expressing its misgiving to the scheme that is now under review. I must also add that had the same objections been raised before me on 6 July 1989, I would not have granted the order in the first place. In this respect, I treat this application similar to that of an application to set aside an interim injunction obtained *ex-parte*, which incidentally also forms part of the order I had granted on 6 July 1989.

For the very reasons that I have expressed, I allow the respondent's application with costs and that the *ex-parte* order dated 6 July 1989 be set aside. I also need to stress that this order should not prevent the applicant from introducing another proposal acceptable to all its creditors especially the respondent.

Also found at [1990] 1 CLJ 827